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IN THE

Supreme Court of the United States

October Term, 1939.

No. [redacted] 113

CHESTER GAINES and THERESA GAINES,
Husband and Wife,

Petitioners,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Frank E. Karelsen, Jr.,
Counsel for Petitioners.

Frederick Baum,
of Counsel.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable, the Chief Justice, and the Associate Justices of the Supreme Court of the United States:

The petitioners, Chester Gaines and Theresa Gaines, pray that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered in the above cause on May 8, 1940, affirming the decision of the Board of Tax Appeals.

Opinions Below.

The memorandum opinion of the Board of Tax Appeals (R. 15) is unreported. The *per curiam* opinion of the Circuit Court of Appeals (R. 27) is not yet officially reported.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 8, 1940 (R. 27). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

Whether, under Section 117 (d) of the Revenue Act of 1934, a husband and wife filing a joint return may deduct losses sustained by the wife from the sale of capital assets to the extent of gains realized by the husband from similar sales.

Statute and Regulations Involved.

The pertinent statute and regulations will be found in the Appendix, *infra,* pp. 7-10.

Statement.

The facts as stipulated (R. 23) and adopted by the Board of Tax Appeals are substantially as follows:

The petitioners were married and living together in New York City, New York, throughout the year 1934 (R. 23).

During that year, the husband, Chester Gaines, realized a net gain from the sale of capital assets of $18,466.41, the entire amount of which was to be taken into account under Section 117 (a) of the Revenue Act of 1934 (R. 23). During the same year, the wife, Theresa Gaines, sustained a net loss from the sale of capital assets in the amount of $35,959.86, of which the amount to be taken into account under Section 117 (a) of the Revenue Act of 1934 was $20,031.59 (R. 23).

The petitioners filed a joint income tax return for 1934 (R. 24). In the return, the net capital gain of the husband

in the amount of $18,466.41 was included in gross income, and the net capital loss of the wife in the amount of $20,031.59 was deducted (R. 24).

In auditing the return, the Commissioner refused to permit the net loss sustained by the wife to be offset against the net gain realized by the husband, and disallowed the deduction of the $20,031.59 net capital loss of the wife, except to the extent of $2,000 thereof (R. 24). On the basis of such disallowance, the Commissioner determined a deficiency of $5,008.55 (R. 13). The Board of Tax Appeals sustained the Commissioner's determination (R. 16). The Circuit Court of Appeals affirmed the Board (R. 27).

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

1. In holding that under Sections 117 (d) and 51 (b) (2) of the Revenue Act of 1934, a loss sustained by one spouse from the sale of capital assets is not deductible to the extent of the gain realized by the other spouse from similar sales where a joint return is filed.

2. In holding that under Sections 117 (d) and 51 (b) (2) of the Revenue Act of 1934, the excess of the losses of one spouse over his or her gains from the sale of capital assets is not deductible from the gains of the other spouse from similar sales when a joint return is filed.

3. In holding that, when a joint return is filed, the limitation under Section 117 (d) of the Revenue Act of 1934 upon the allowance of losses from the sale of capital assets is to be computed separately as to each spouse with respect to his or her individual transactions, and without regard to the gains or losses of the other spouse from similar sales.

4. In not holding that, when a joint return is filed, Section 117 (d) of the Revenue Act of 1934 limits the de-

ductibility of losses sustained by each spouse from the sale of capital assets only to the extent of the aggregate gains realized by both spouses (plus $2,000) from similar sales.

Reasons for Granting the Writ.

1. The decision of the Court below is in square conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *Janney* v. *Commissioner,* 108 F. (2d) 564. This Court granted a writ of certiorari in the *Janney* case on April 29, 1940, upon the petition of the Commissioner (*Helvering* v. *Janney,* No. 843, October Term, 1939, certiorari granted April 29, 1940).

The question in the instant case is the same as the question in the *Janney* case, both arising under the Revenue Act of 1934. In the instant case, the *per curiam* opinion of the Court below affirmed the decision of the Board "upon the authority of *Pierce* v. *Helvering,* 100 F. (2d) 397 (C. C. A. 2)" (R. 27). In the *Janney* case, the Court expressly rejected the decision in the *Pierce* case (108 F. [2d] at 566).

2. This case presents an important question of federal law which has not been, but should be, definitely settled by this Court.

The question is raised by the provision which has been included in the income tax law ever since the Revenue Act of 1932, limiting the deductibility of losses to the extent of gains from the sale or exchange of assets. The interpretation of this limitation in the 1932 Revenue Act with reference to a joint return first came before the appellate Courts in *Pierce* v. *Commissioner* (*supra*). In that case, the Court of Appeals for the Second Circuit held that, under Section 23 (r) of the Revenue Act of 1932, the losses of one spouse from sales of securities constituting noncapital assets could not be offset against the gains of the other spouse from similar sales in a joint return. Judge

Learned Hand filed a strong dissenting opinion (100 F. [2d] at 398).

The *Pierce* case has been followed by the Courts of Appeals for the First and Fourth Circuits solely in deference to its prior precedent and not because of independent reasoning impelling the same conclusion. Thus in *Nelson* v. *Commissioner,* 104 F. (2d) 521, the Court of Appeals for the Fourth Circuit indicated that a majority agreed with Judge Hand's dissent:

> "While a majority of this Court are much impressed with the reasoning of Judge Learned Hand in his dissenting opinion in the *Pierce* case, the legal question involved is a close one and we feel that we should follow the decisions of the First and Second Circuits, particularly in view of the denials of certiorari by the Supreme Court."

In *Sweet* v. *Commissioner,* 102 F. (2d) 103, certiorari denied 307 U. S. 627, the Court of Appeals for the First Circuit stated:

> "While the decision of the Court of Appeals for the Second Circuit may involve some doubt we do not regard it as clearly wrong and, being squarely in point, we follow it."

The foregoing decisions failed to give effect to the underlying theory of the privilege granted to husbands and wives in filing a joint return, embodied in Section 51 (b) (2). The very privilege is based upon disregarding the source; the spouses exercise it only when they can get some benefit from it; that is, when some loss of one can be set off against some gain of the other.

Moreover, the foregoing decisions have extended the scope of the limitation beyond the expressed purpose of Congress. The only purpose given by Congress for introducing the limitation upon the deductibility of securities losses in the 1932 Revenue Act was to prevent such losses from being offset against ordinary income, not to diminish

or destroy the pre-existing privilege of spouses to set off one's losses against the other's gains in a joint return.*

Substantially the same question, arising under the Revenue Act of 1934, Section 117 (d), was presented in *Janney* v. *Commissioner* (*supra*) and in the instant case. In the *Janney* case, the Court of Appeals for the Third Circuit rejected the majority opinion in the *Pierce* case. (108 F. [2d] at 566). In the instant case, the Court below affirmed the decision of the Board upon the authority of the *Pierce* case (R. 27).

The same question is presented by Section 117 (d) of the Revenue Act of 1936, which is identical in language with Section 117 (d) of the Revenue Act of 1934. Substantially the same question is raised by cognate provisions in Section 117 (d) of the Revenue Act of 1938 and of the Internal Revenue Code.

Thus, the question of federal law raised in the instant case has been presented to the Courts in numerous cases arising under the 1932 and 1934 Revenue Acts, has resulted in conflicting decisions, and will continue to be raised under the subsequent Revenue Acts, until definitely settled by decision of this Court.

Conclusion.

In view of the conflict of decisions and the general importance of the question presented, it is respectfully submitted that the petition should be granted.

Dated, May 17, 1940.

Chester Gaines and Theresa Gaines,
Petitioners.

By Frank E. Karelsen, Jr.,
Counsel for Petitioners.

Frederick Baum,
of Counsel.

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*See Sen. Rep. No. 665, 72d Cong. 1st Sess. p. 17; H. Rep. No. 708, 72d Cong. 1st Sess. p. 12; Hearings before Senate Finance Committee, 72d Cong. 1st Sess. p. 31; Hearings before Ways & Means Committee, 73d Cong. 2nd Sess. p. 46.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

* * * * *

SEC. 51. INDIVIDUAL RETURNS.

* * * * *

(b) *Husband and Wife.*—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

* * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation, and shall not be included in determining the applicability of such limitation to other losses.

* * * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 51-1. *Individual returns.*—For each taxable year every single person and every married person not living with husband or wife for any part of the

taxable year, whose gross income as defined in sections 22 and 116 is $5,000 or over, or whose net income as defined in section 21 is $1,000 or over, must make a return of income. Every married person living with husband or wife for any part of the taxable year, but not at the close of the taxable year, must make a return if his gross income for the taxable year is $5,000 or more, or his net income is equal to, or in excess of, the credit allowed him by section 25 (b) (1) and (3) (computed without regard to his status as the head of a family). (See article 25-7.) A husband and wife living together for the entire year need make no returns unless their aggregate gross income for the taxable year is at least $5,000, or their aggregate net income is at least $2,500. If their aggregate net income for the taxable year is $2,500 or more, or their aggregate gross income is $5,000 or more, either each must make a return, or the income of each must be included in a single joint return. A husband and wife living together at the close of the taxable year but not during the entire taxable year must make a return or returns if their aggregate gross income for the taxable year is $5,000 or more, or their aggregate net income is equal to, or in excess of, the credit allowed them by section 25 (b) (1) and (3) (computed without regard to the status of either of them as the head of a family). (See article 25-7). If the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income. A joint return of husband and wife may be filed only if they were living together at the close of their taxable year. If one spouse dies prior to the last day of the taxable year, the surviving spouse may not include the income of the

deceased spouse in a joint return for such taxable year.

* * * * *

ART. 117-5. *Application of section 117 in the case of husband and wife.*—In the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

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